

# **Price Discrimination and Foreclosures: Two Faces of Predatory Lending**

**Debbie Gruenstein Bocian, Keith Ernst and Wei Li, Unfair  
Lending: The Effect of Race and Ethnicity on the Price of  
Subprime Mortgages**

**Morgan J. Rose, Predatory Lending Practices and  
Subprime Foreclosures: Distinguishing Impacts by Loan  
Category**

**Alan M. White**

# Bocian Ernst & Li

- Strengthens case for race dimension in mortgage pricing
- New contribution – combine loan-level data on borrower credit scores and LTV with HMDA APR pricing data
- Limitations – disparities within subprime segment only, binary price data, record matching issue

# Advancing the Debate

- No secret explanation for race disparities in mortgage pricing
  - Response to industry omitted variables defense
- Only way to isolate race more clearly as pricing variable would be to get FICO and property value into HMDA dataset
- All the variables used by lenders are here



- Borrower variables are:
  - FICO score
  - Property value
  - Mortgage rates
- Loan product variables are:
  - Loan amount
  - Documentation level
  - Prepayment penalty
  - Broker premium paid

# Policy Implications

- Steering problem
  - CRA enforcement, low-price lenders failing to market to high-priced borrowers
  - Suitability or fiduciary duty for brokers
- Pricing discretion problem
  - Require lender validation of pricing algorithms
  - Transparency – Adv rules: rate calculators on Internet
  - Transparency – early binding written price offer
  - Reduce complexity with standardized products
  - Suitability or fiduciary duty – trusted advisor for product selection

# Rose on Foreclosures

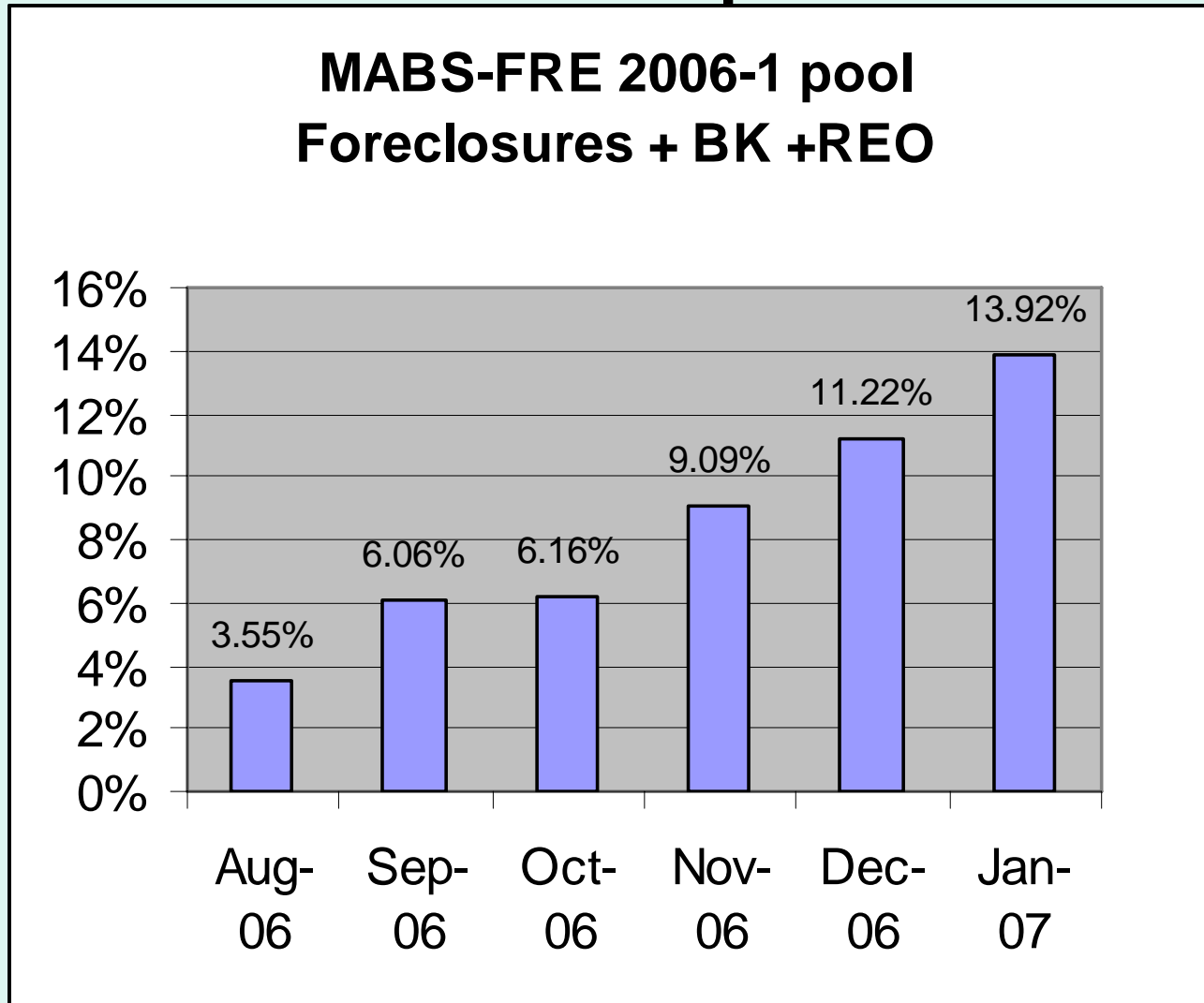
- 32,618 Chicago subprime mortgages originated 1999-2003, 13% entered foreclosure
- Refinance ARMs with three-year prepayment penalties had 20.6% foreclosure incidence
- No-doc loans have lower foreclosure rates, but are less seasoned (i.e., few originated in 1999, more in 2003)
- Limitations – Heterogeneity of subprime
  - Chicago (inner city) vs. purchase loans in CA
  - 1999 vs. 2003 vintages

# Key Findings

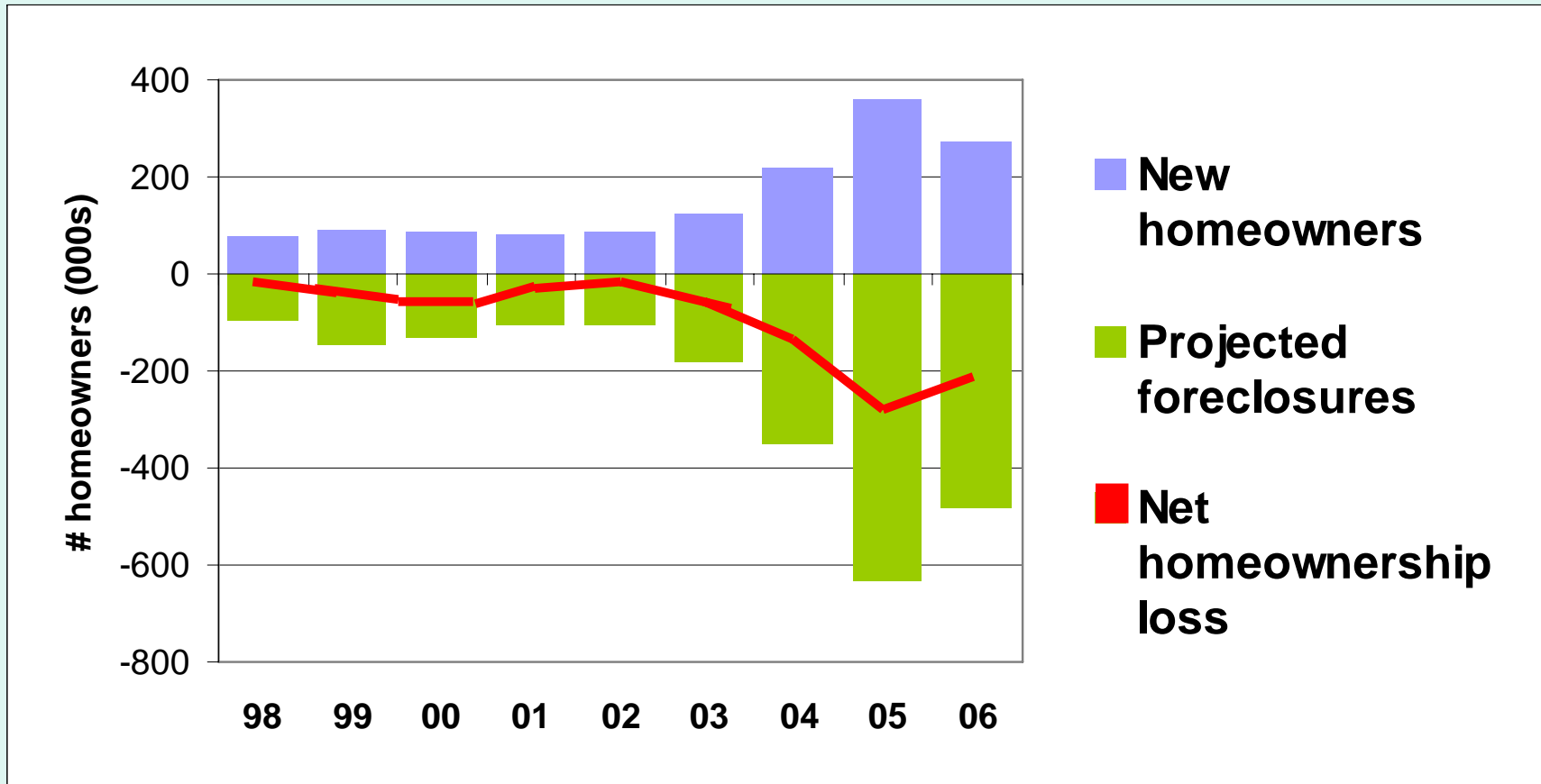
- Purchase and refinance mortgages have very different risks
  - Odd case of no-doc purchase loans, much lower foreclosures, possibly market segment anomaly
- Layering of risk factors increases foreclosure rate more than single factors



# Evolution of Subprime Today



# Subprime Homeownership: A Net Loss



# Policy implications

- Market will accept high levels of foreclosure over time, intervention needed to prevent major harm
- Regulation and guidance should treat purchase mortgages and refinancings separately
- Scrutinize lenders who combine rather than offset risky product features
- Outcomes approach –benchmark foreclosure rates, target lenders with highest rates for exam or licensing action
- Internalize costs – community impact fees